

Internal Revenue Service

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Person To Contact:

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Refer Reply To:

CC:PSI:B03

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Date:

October 05, 2010

Legend

Company =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

LLC =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Trust 11 =

Trust 12 =

Trust 13 =

Trust 14 =

Trust 15 =

Dear :

This letter responds to your letter dated April 21, 2010, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

Company was incorporated in D1 under the laws of State and elected under § 1362(a) to be an S corporation effective D2.

On D3, LLC purchased all of the shares of Company stock. In D4, Company learned that LLC was an ineligible S corporation shareholder and that its S corporation election had terminated on D3. Subsequently, on D5, LLC distributed all of the shares of Company stock to members of LLC in proportion to their ownership interests in LLC as of D3. It is represented that the members of LLC who became shareholders of Company (except as described below) are eligible S corporation shareholders under § 1361(b)(1).

Certain members of LLC, Trust 1 through Trust 15 (collectively, Trusts) were not eligible S corporation shareholders because Trusts, which are represented to qualify as electing small business trusts (ESBTs) within the meaning of § 1361(e), each failed to make the required election under § 1361(e)(3).

Company represents that there was no intent to terminate Company's S corporation election and that the transfer of Company stock to LLC was inadvertent and not motivated by tax avoidance or retroactive tax planning. Company also represents that each Trust's failure to timely file an ESBT election was inadvertent and not motivated by tax avoidance or retroactive tax planning. Company further represents that Company and its shareholders have treated Company as an S corporation since D3. In addition, Company and its shareholders have agreed to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Law and Analysis

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible shareholder and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first tax year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the facts submitted and representations made, we conclude that Company's S corporation election terminated on D3 when LLC acquired Company stock. We also conclude that this termination was inadvertent within the meaning of § 1362(f). In addition, to the extent Company's S corporation election would have terminated on D5 when LLC distributed Company's stock to Trusts, such termination was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), Company will continue to be treated as an S corporation from D3, and thereafter, unless Company's S corporation election is otherwise terminated under § 1362(d), provided that Trusts file ESBT elections with the appropriate service centers within 120 days of the date of this letter to be effective D3. A copy of this letter should be attached to each of the ESBT elections.

From D3 to D5, the members of LLC who received Company's stock, including Trusts, shall be treated as if they held shares in Company stock directly (taking into account any subsequent transfers of Company stock) and Trusts shall be treated as trusts described in § 1361(e)(1). Accordingly, Company's shareholders, in determining their income tax liabilities for the period beginning D3 and thereafter, must include their pro rata share of separately stated and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company under § 1368. If Company or its shareholders fail to treat Company as described above, this ruling will be null and void.

Except for the specific rulings above, we express or imply no opinion concerning the tax consequences of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation or the qualification of any one of the Trusts as an ESBT.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter
A copy for § 6110 purposes